

A

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 96-383-E - ORDER NO. 97-310
APRIL 21, 1997

IN RE: Application of Duke Power Company for) ORDER
Approval to Issue Securities in) RULING ON
Connection with a Business Combination) APPLICATION
Transaction with PanEnergy Corporation.) OF DUKE
) POWER COMPANY

This matter comes before the Public Service Commission of South Carolina (the "Commission") on the Application of Duke Power Company ("Duke" or the "Company") for approval, pursuant to South Carolina Code Sections 58-27-1300, 58-27-1710, 58-27-1720 and 58-27-1730 to issue securities in connection with a business combination transaction with PanEnergy Corp. ("PanEnergy").

The Commission's Executive Director instructed Duke to publish, one time, a prepared Notice of Filing in newspapers of general circulation in the affected area. The purpose of the Notice of Filing was to inform interested parties of the Company's Application and of the manner and time in which to file the appropriate pleadings for participation in the proceeding. Duke complied with the instructions and provided the Commission with Affidavits of Publication of the Notice of Filing in newspapers in Charlotte, N. C. and Anderson, Spartanburg and Greenville, S.C.

On January 24, 1997, the Consumer Advocate for the State of South Carolina (the "Consumer Advocate") filed a Petition to

Intervene which was allowed by the Commission on January 28, 1997.

The Commission also established dates for prefiling of testimony which were complied with by the parties. The Commission scheduled a public hearing to begin at 10:30 a.m. on Thursday, March 6, 1997.

The Consumer Advocate conducted discovery through data requests and meetings with Duke during December 1996 through February 1997. The Commission Staff (the "Staff") also met with Duke and reviewed data concerning the PanEnergy transaction. The Consumer Advocate and Duke entered into a Stipulation (the "Stipulation") dated February 28, 1997 concerning conditions applicable to the transaction and admission of prefiled testimony.

The Commission is informed that, in addition to the required approval by the Public Service Commission of South Carolina of the transaction, approvals are needed from Duke's and PanEnergy's shareholders, the North Carolina Utilities Commission, the Federal Energy Regulatory Commission ("FERC"), the Federal Trade Commission and the United States Department of Justice. Duke has received notices of early termination from the Federal Trade Commission and the United States Department of Justice. The favorable early termination notice indicates that the agencies do not anticipate further examination of the transaction. The North Carolina Utilities Commission conducted hearings on March 18, 1997 and issuance of an order is pending. Duke filed its application on the PanEnergy merger with the FERC on February 3, 1997 in Docket No. EC97-13-000. A copy of the FERC application was filed

with this Commission. A decision is pending from the FERC. Finally, Duke and PanEnergy shareholders will vote on the business combination transaction at their annual meetings on April 24, 1997.

A hearing was commenced on March 6, 1997 at 10:30 a.m. in the Commission's Hearing Room. The Honorable Guy Butler, Chairman, presided. Duke was represented by William F. Austin, Esquire, Mary Lynne Grigg, Esquire and William Larry Porter, Esquire. The Consumer Advocate was represented by Philip S. Porter, Esquire, Nancy V. Coombs, Esquire and Hana Pokorna-Williamson, Esquire. The Staff was represented by F. David Butler, General Counsel.

Duke presented William R. Stimart, Vice President, Rates and Regulatory Affairs, as a witness in the proceeding to testify to the Stipulation entered into by Duke and the Consumer Advocate. The Stipulation was entered into the record as Hearing Exhibit 1. The testimony of William H. Grigg, Chairman of the Board and Chief Executive Officer, and William R. Stimart, including exhibits, were entered into the record as Hearing Exhibit 2. Hearing Exhibit 3 was reserved during the hearing for the Joint Proxy Statement which was subsequently filed by Duke. During the hearing the Commission indicated that it would allow an informational filing of the Duke and the Public Staff-North Carolina Utilities Commission Stipulation. Duke and the Consumer Advocate filed a letter indicating that the Consumer Advocate and Duke agreed that the Commission should have the opportunity to review item 9(p) of the Stipulation between Duke and the Public

Staff-North Carolina Utilities Commission in Docket No. E-7, Sub 596.

After review of Duke's Application, testimony, exhibits, the Stipulation and applicable law, the Commission makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. Duke proposes to engage in a business combination transaction with PanEnergy. Duke proposes to issue securities to enable Duke to acquire PanEnergy by issuing 1.0444 shares of Duke Common Stock for each outstanding share of PanEnergy common stock at the effective time of the transaction. PanEnergy is a publicly held corporation headquartered in Houston, Texas and was founded more than 65 years ago. PanEnergy operates approximately 37,000 miles of natural gas pipeline and owns a network of four interstate pipelines.

2. The merger agreement between Duke and PanEnergy was signed November 24, 1996 and was subject to the approval of this Commission pursuant to Sections 58-27-1300, 58-27-1710, 58-27-1720 and 58-27-1730, S.C. Code Ann. (1976, as amended).

3. The transaction is structured as a merger of a new Delaware subsidiary of Duke into PanEnergy, also a Delaware corporation, in which Duke Common Stock will be issued to the PanEnergy stockholders in exchange for their PanEnergy stock, with an exchange ratio of 1.0444 shares of Duke Common Stock for each share of PanEnergy common stock. The result is that PanEnergy will be a wholly-owned subsidiary of Duke, the former PanEnergy

stockholders will become Duke shareholders, and Duke will change its name to Duke Energy Corporation. Duke will retain its corporate form, and will continue to own all its pre-acquisition assets.

4. A total of approximately 166,000,000 shares of Duke Common Stock will be issued and reserved in connection with that transaction. Duke will not issue any more shares than are required under the agreement. The purpose of the issue is to acquire 100% of the outstanding shares of PanEnergy. The transaction will be accounted for as a "pooling of interests." A "pooling of interests" is accomplished by merely adding together the assets, liabilities and net worth that exist at the completion of the transaction. There is no goodwill or acquisition adjustment in the transaction. PanEnergy's debt will remain its debt, without any guarantees of such debt from Duke.

5. PanEnergy's book value of its assets totaled approximately \$8 billion supported by a shareholder common equity investment of approximately \$2.4 billion.

6. The combined Duke Energy Corporation will have assets of \$21 billion, revenues of \$10 billion and a common equity investment of over \$7 billion. This combination will make Duke Energy a stronger and more competitive company in the future. Duke Energy will be positioned to better withstand any future economic adversities, which will benefit Duke's South Carolina retail customers.

7. Duke will issue about 158 million shares of Duke Common

Stock in the merger, in exchange for approximately 151 million PanEnergy shares that were outstanding on November 22, 1996, just before the merger agreement was signed. The implied price is \$50.00 per PanEnergy share, based on \$47.875 closing price for Duke's Common Stock on November 22, 1996. Because PanEnergy's stock will cease to be publicly held, it is necessary for Duke to make provision for PanEnergy's outstanding employee stock options and restricted stock awards and forward commitments for such options and awards, which Duke will assume in the transaction, and Duke will reserve about 7 million shares of its common stock for that purpose. PanEnergy had reserved 452,000 shares of its common stock for issuance on conversion of its 9% Convertible Notes due 1997-2004, and Duke will agree to issue up to 472,069 shares of its common stock upon conversion of these notes. Duke is not, however, proposing to assume the repayment obligations for notes that are not converted. It is not possible at this time to know exactly how many Duke shares will be issued in the merger or reserved for stock options or restricted stock because between now and the effective time of the merger, PanEnergy is permitted under the merger agreement to issue additional shares through its dividend reinvestment program and, in the normal course of business, to grant additional employee stock options and restricted stock awards. Also, some of the outstanding stock options may be exercised during that interim period.

8. Duke intends to retain its central focus to be a premier provider of traditional electric service.

9. The Commission notes that Duke's Application was uncontested following extensive negotiations and a Stipulation entered into between Duke and the Consumer Advocate. The Stipulation resolved all matters between the two parties prior to the hearing. Duke agreed to the conditions in the Stipulation which are intended to protect South Carolina retail customers from any detrimental effect of the merger on retail rates and charges. The Stipulation was entered into evidence in the hearing as Hearing Exhibit 1 and it allowed for the following:

1. All costs of the merger, and all corporate cost increases, if any, attributable to the merger shall be booked "below the line" for all purposes that affect Duke's South Carolina retail electric rates and charges. For purposes of this Agreement "corporate cost increases" (including any additional in-house costs which would have otherwise not been incurred) is defined as costs in excess of the level that Duke would have incurred on a stand-alone basis.

2. All of Duke's A&G expenses will be allocated consistent with past practices by either direct assignment or formula allocation so that no cost increases attributable to the merger are reflected in electric operations and so that any cost reductions may be properly allocated.

3. An amount equal to Duke's net equity investment in PanEnergy (i.e., the amount initially recorded as net investment in PanEnergy in NARUC Account 123, plus future earnings of PanEnergy less dividends paid by PanEnergy) will be eliminated from Duke's unconsolidated capital structure for all purposes that affect Duke's South Carolina retail rates and charges.

4. To the extent that any down-grading of Duke's debt securities by a rating agency during the first three calendar years following the effective date of the merger is attributable to the merger, Duke will, for all purposes affecting its South Carolina retail rates and charges, use a surrogate cost of debt applicable to all financings, refundings and refinancings through December 31, 2000, that reflects a

debt rating no lower than Duke's debt rating on December 31, 1996.

5. Duke shall, in accordance with South Carolina law, continue to provide the Commission access to Duke's books of accounts and shall provide the Commission with access to the books of accounts of PanEnergy, and all of Duke's financial books and records will continue to be maintained in Charlotte, North Carolina.

6. Duke shall not issue or reserve for issuance pursuant to this Order any shares of its Common Stock or any other securities in excess of those required by the terms of the Merger Agreement between Duke, Duke Transaction Corporation and PanEnergy dated as of November 24, 1996.

7. Duke shall not make any changes in its transfer pricing policies or procedures with respect to transfer between Duke and its affiliates, including PanEnergy and its affiliates, as a result of the merger without first reporting to the Commission on any such proposed change at least sixty days before it is implemented.

8. Duke shall not provide its affiliates, including PanEnergy and its affiliates, or any competitor with confidential retail electric customer data unless the customer grants written permission to do so.

CONCLUSIONS

1. The Commission concludes that this matter has received due hearing and adequate notice was given to the public.

2. Upon review and study of the Application, testimony and exhibits, and other supporting data, the Commission is of the opinion, and so finds, that the Company is a public utility subject to the jurisdiction of this Commission with respect to its retail rates, services and securities issues and that the issuance of the shares as set forth in the Company's Application is reasonably necessary, appropriate and proper for the purpose for which they

are to be issued.

3. The Commission concludes that: (i) the purpose of the issue and assumption of securities is proper, (ii) the property to be acquired by the issue is appropriately valued, and (iii) the amount of such securities prepared to be issued and assumed is reasonably necessary for the acquisition of PanEnergy; and

4. The Commission concludes that this Order shall serve as a certificate of authority to Duke setting forth the Commission's opinions and findings that:

a. the issuance and reservation of approximately 166,000,000 shares of Duke Common Stock is reasonably necessary for Duke's business combination transaction with PanEnergy. The transaction includes the issuance of shares of stock without par value, and issuance of Duke Common Stock in the form of restricted stock awards or upon exercise of employee stock options granted or to be granted to PanEnergy employees and upon conversion of certain convertible notes of PanEnergy and reserve shares of its Common Stock for such purpose; and

b. the value of the property to be acquired by the issuance of securities is approximately \$8 billion supported by PanEnergy shareholder common equity investment of approximately \$2.4 billion.

5. The purposes of the issuance of Duke's Common Stock are lawful objects within the corporate purposes of Duke and are within

the limits of authority and purposes set forth in Duke's Articles of Incorporation, as amended, which are on file with this Commission.

6. The Commission has fully examined the terms of the Stipulation between Duke and the Consumer Advocate, believes it is in the best interest of Duke's South Carolina retail customers and hereby adopts the conditions of that Stipulation as set out in paragraph 9 of the above Findings of Fact.

7. In its application to the FERC, Duke has included an undertaking that its wholesale customers, subject to FERC jurisdiction, would not be affected by costs attributable to the merger and that rates to such customers would be capped through December 31, 2000, at the levels in effect on December 31, 1996. The Commission believes that it is appropriate to ensure that Duke's South Carolina retail electric customers are additionally protected and orders that Duke's base electric retail rates be capped at the existing levels from the date of this Order approving the merger through the year 2000. The rate cap will not apply to annual fuel cost adjustment proceedings pursuant to S.C. Code 58-27-865 or to the termination of the Schedule J sale adjustment rider. Duke may file a request for an increase in base rates under Title 58 of the S.C. Code of Laws during the cap period, including a cost deferral for inclusion in base rates after the end of the cap period, solely for one or more of the following reasons:

i. to reflect the financial impact of governmental action (legislative, executive or

regulatory) having a substantial specific impact on the electric industry generally or on a segment thereof that includes Duke, including but not limited to major expenditures for environmental compliance; or

ii. to reflect the financial impact of major expenditures to restore or replace property damaged or destroyed by force majeure.

Such a request will include a specification of the reasons therefor and an accurate quantification of the financial impact thereof.

8. Based on a review of the record the Commission concludes that the proposed combination will not have any adverse effect on Duke's South Carolina retail electric rates. Duke's South Carolina retail cost of service is not adversely affected by the transaction, and neither are its jurisdictional revenues or expenses. While there is a possibility that Duke's combination with PanEnergy may have a downward influence on Duke's AA bonding rating, even if Duke's bond rating were lowered somewhat, this would not affect Duke's ability to serve its South Carolina retail customers.

9. The business combination transaction and issuance of the securities described herein, will not adversely affect Duke's South Carolina retail electric operations or customers. The effect of the business combination on Duke's consolidated financial condition, and on its ability to thrive in a rapidly changing energy environment will be positive and will benefit Duke's South Carolina retail customers.

10. The transaction will combine the financial strengths of both companies and will ultimately benefit Duke's customers by providing Duke with greater business risk diversification and a broader asset base.

IT IS, THEREFORE, ORDERED:

1. That Duke Power Company's Application to engage in a business combination transaction with PanEnergy Corp as described herein and to issue its securities in the manner set forth herein, and in its Application, is approved.

2. That the conditions set forth in paragraph 7 of the Conclusions of this Order and subparagraphs (a) through (h) herein below are hereby approved and that Duke is hereby ordered to comply with such conditions:

(a) All costs of the merger, and all corporate cost increases, if any, attributable to the merger shall be booked "below the line" for all purposes that affect its South Carolina retail electric rates and charges. "Corporate cost increases" (including any additional in-house costs which would have otherwise not been incurred) is defined as costs in excess of the level that Duke would have incurred on a stand-alone basis.

(b) All of Duke's A & G expenses will be allocated consistent with past practices by either direct assignment or formula allocation so that no cost increases attributable to the merger are reflected in

electric operations and so that any cost reductions may be properly allocated.

(c) An amount equal to Duke's net equity investment in PanEnergy (i.e., the amount initially recorded as net investment in PanEnergy in NARUC Account 123, plus future earnings of PanEnergy less dividends paid by PanEnergy) will be eliminated from Duke's unconsolidated capital structure for all purposes that affect its South Carolina retail rates and charges.

(d) To the extent that any down-grading of Duke's debt securities by a rating agency during the first three calendar years following the effective date of the merger is attributable to the merger, Duke will, for all purposes affecting its South Carolina retail rates and charges, use a surrogate cost of debt applicable to all financings, refundings and refinancings through December 31, 2000, that reflects a debt rating no lower than Duke's debt rating on December 31, 1996.

(e) Duke shall, in accordance with South Carolina law, continue to provide the Commission access to its books of accounts and shall provide the Commission with access to the books of accounts of PanEnergy, and all of Duke's financial books and records will continue to be maintained in Charlotte, North Carolina.

(f) Duke shall not issue or reserve for issuance pursuant to this Order any shares of its common stock or any other securities in excess of those required by the terms of the Merger Agreement between Duke, Duke Transaction Corporation and PanEnergy dated as of November 24, 1996.

(g) Duke shall not make any changes in its transfer pricing policies or procedures with respect to transfer between Duke and its affiliates, including PanEnergy and its affiliates, as a result of the merger without first reporting to the Commission on any such proposed change at least sixty days before it is implemented.

(h) Duke shall not provide its affiliates, including PanEnergy and its affiliates, or any competitor with confidential retail electric customer data unless the customer grants written permission to do so.

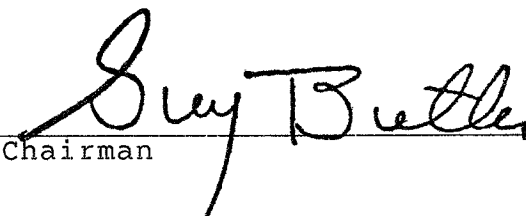
IT IS FURTHER ORDERED, that:

1. Approval of this Application does not bind the Commission as to any ratemaking treatment of this issuance; and


2. This Order shall not, in any way, affect or limit the right, duty, or jurisdiction of the Commission to further investigate and order revisions, modifications, or changes with respect to any provision of this Order in accordance with the law.

3. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Deputy Executive Director
(SEAL)